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E.O. 11652: GDS
TAGS: EGEN, ECON
SUBJ: ASSESSING POTENTIAL POLITICAL IMPACT STEMMING FROM
- EGYPT'S DOMESTIC ECONOMIC CONDITIONS

REF: STATE 107655

1. AS NOTED PARA 1 REFTTEL, THERE ARE INDEED TWO SIDES TO CURRENT EGYPTIAN ECONOMIC PICTURE. EXTERNAL POSITION, I.E., ABILITY TO SERVICE DEBT AND PAY FOR IMPORTS, HAS IMPROVED MIGHTILY IN PAST YEAR. REASON HAS BEEN RESPONSE OF DONORS TO SPECTRE OF COLLAPSE OF SADAT REGIME OCCASIONED BY URBAN MOB REACTION TO MISHANDLED 1977 BUDGET MOVE TO REDUCE SUBSIDY COSTS. OPEC ARABS, IMF, AND USG ALL DECIDED TO HELP OUT OVER COMING YEAR, FINANCIAL REFORMS OR NO. MOST IMPORTANTLY, MASSIVE AMOUNT OF GODE BOP ASSISTANCE WAS MADE AVAILABLE (AND WAS REASONABLY WELL MANAGED BY GOE ECONOMIC GROUP); EGYPT EFFECTIVELY IS STILL SUBSISTING AT THIS POINT, UP TO DATE ON ITS INTERNATIONAL OBLIGATIONS, ON RESIDUUM OF THOSE FUNDS, PLUS IMPROVED EARNINGS IN PETROLEUM AND SERVICES SECTORS AND LARGE-SCALE REMITTANCES FROM ABROAD.

2. DOMESTIC ECONOMIC SITUATION AS IT AFFECTS AVERAGE EGYPTIAN, HOWEVER, HAS IF ANYTHING DETERIORATED SINCE
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BEGINNING OF 1977. NECESSARY IMPORTS CONTINUE TO COME IN (AND ARE PAID FOR), BUT THERE ARE MORE MOUTHS TO FEED EVERY DAY, SUPPLY DISTRIBUTION SYSTEM IS CHAOTIC, DEVELOPMENT PROJECTS ARE SLOW IN GETTING OFF GROUND, PRODUCTION AND EXPORT LEVELS REMAIN MORE OR LESS STAGNANT, AND COSTS TO CONSUMERS ARE RISING (DUE PARTLY TO INCREASED COSTS OF MANY IMPORTED ITEMS) WHILE INCOME

LEVELS ARE NOT. AS A RESULT, WAGE/PRICE SQUEEZE IS EVER-TIGHTENING ON GREAT MASS OF EGYPTIAN POPULACE. MARGIN ABOVE BARE SUBSISTENCE LEVEL STILL EXISTS FOR MOST OF RURAL AND MAJORITY OF URBAN POPULATION-- AND THERE ARE SOME FORTUNIES BEING MADE IN PRIVATE SECTOR-- BUT INFLATION HAS BECOME SEVERE PROBLEM. POTENTIAL FOR DOMESTIC POLITICAL DIFFICULTIES ON THIS SCORE IS IN REALITY HEIGHTENED IN COMPARISON WITH THAT OBTAINING IN JANUARY 1977. DIFFERENCE BETWEEN WAGE AND PRICE INDICES HAS NARROWED MARKEDLY SINCE THAT TIME, WITH RISE IN PRICES FAR OUTSTRIPPING MODEST INCREASES IN WAGE LEVELS.

3. THUS, EXAMINATION OF CURRENT STATE OF ECONOMY AND POLITICAL IMPLICATIONS THEREOF MUST PROCEED FROM THESE TWO VERY DIFFERENT PREMISES: EXTERNALLY EGYPT HAS IMPROVED ITS LOT SIGNIFICANTLY, ALTHOUGH MEDIUM-TERM PROBLEMS LOOM, WHILE INTERNAL DIFFICULTIES ARE GRADUALLY BECOMING EXACERBATED IN ABSENCE OF PRODUCTIVITY/INCOME RISES COMMENSURATE WITH REFORM-DICTATED PRICE INCREASES.

4. REPEATED BELOW ARE DEPARTMENT'S QUESTIONS IN SEQUENCE SET FORTH IN REFTTEL, ALONG WITH OUR RESPONSES TO EACH.

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5. (PARA 3. BASIC ECONOMIC CONDITIONS.)

--ARE DOMESTIC REPERCUSSIONS OF GOE ECONOMIC POLICY BETTER, WORSE OR ABOUT AS MIGHT HAVE BEEN ANTICIPATED?

EFFECT OF GOE'S GENERAL ECONOMIC POLICY THRUST, CHARACTERIZED AS THE "OPEN DOOR", AND RELATED REFORM EFFORTS OF LATE, WHILE TROUBLING, HAS BEEN AS MIGHT HAVE BEEN EXPECTED, GIVEN LEGACY OF PAST POLICIES AND GOVT PERFORMANCE. IT HAS BEEN A TRAUMATIC EXPERIENCE OVER PAST FOUR YEARS IN CHANGING FROM A CLOSED, SOCIALIST SYSTEM TO A MORE OPEN, MIXED ECONOMY. DISTORTIONS PREVIOUSLY BUILT INTO THE ECONOMY, NOTABLY SUBSIDY SYSTEM AND PRICE CONTROLS, HAVE PROVED NOT ONLY HARD TO REMEDY DURING THIS PERIOD OF TIME, BUT THEY HAVE INCREASED IN NEGATIVE IMPACT WITH SIGNIFICANT RISE IN WORLD PRICE LEVELS OF COMMODITIES COMMONLY IMPORTED. EGYPT HAS BEEN STRUGGLING TO REVAMP ITS ECONOMY, MAKING IT MORE RESPONSIVE TO MARKET FORCES--AND AT THE SAME TIME TO PRESERVE (LOW) PURCHASING POWER OF ITS CITIZENRY. THIS DIFFICULT TASK HAS BEEN FURTHER COMPLICATED LATELY BY RECENT GREATER-THAN-EXPECTED INCREASES IN PRICES OF A NUMBER

OF BASIC CONSUMER ITEMS, INCLUDING FOOD STAPLES, DUE TO REDUCTIONS, ALBEIT RELATIVELY SMALL, IN OUTPUT OF LOCALLY-PRODUCED EDIBLES. SUCH PRICE RISES ARE RECEIVED WITH VOCAL CRITICISM BY THOSE ADVERSELY AFFECTED, I.E., GREAT BULK OF URBAN POPULATION. WHEN CONSIDERED IN CONTEXT OF GRADUAL BUT SUBSTANTIAL PRICE RISES SINCE 1974, RECENT ACCELERATION OF THIS TREND IS BELIEVED CLEARLY TO HAVE POTENTIAL FOR AN UNSETTLING DOMESTIC REACTION. --TO WHAT EXTENT IS "MAN ON THE STREET" AWARE OF BROADER POLICY OBJECTIVES? DOES AWARENESS (OR LACK THEREOF) MAKE ANY DIFFERENCE, EITHER IN TERMS OF POLICY IMPLEMENTA-

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TION OR GOVERNMENT RESOLVE TO PRESS FORWARD?

THE AVERAGE EGYPTIAN LACKS SUFFICIENT SOPHISTICATION TO BE AWARE OF POLICY OBJECTIVES AND DIFFICULT DILEMMAS CONFRONTING GOE. HE IS, HOWEVER, AWARE OF THE GRANDIOSE PROMISES MADE ABOUT THE OPEN DOOR POLICY. ALTHOUGH PUBLIC EXPECTATIONS WERE NO DOUBT LOWER THAN FOUR YEARS AGO WHEN HOPES WERE RAISED, GOE CREDIBILITY ON ECONOMIC MATTERS IS AND ALWAYS HAS BEEN LOW.

WIDESPREAD DISCONTENT OVER RISING PRICES, LACK OF HOUSING AND DETERIORATING SERVICES IS A MAJOR INHIBITING FACTOR ON THE DECISION-MAKING, BOTH IN IMPLEMENTATION OF POLICY (E.G., ENFORCEMENT OF RENTAL AND TAX LAWS) AND NEW POLICY INITIATIVES (E.G., RELUCTANCE TO BITE THE IMF BULLET ON SUBSIDIES). THE SPECTRE OF JANUARY 1977 RIOTS HANGS HEAVY OVER CABINET DELIBERATIONS AND FEAR OF RENEWED, VIOLENT REACTION TO ECONOMIC POLICIES IS AT POINT WHERE AT LEAST ONE KEY MINISTER NOW CARRIES HAND GUN TO WORK.

--IS HOARDING A REAL PROBLEM AT PRESENT? IF SO, WHAT ARE IMPLICATIONS?

WHILE IT IS DIFFICULT TO OBTAIN HARD EVIDENCE, HOARDING
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IS NOT CONSIDERED PROBLEM FACING THE ECONOMY. WITHHOLD-
ING PRODUCE FROM THE MARKET OCCURS FOR SPECULATIVE PUR-
POSES, BUT HOARDING AS SUCH IS NOT A COMMON COMPLAINT.
MOST EGYPTIANS CONSUME LARGELY PERISHABLE ITEMS EVERY DAY
(VEGETABLES, FRUITS AND BREAD). THERE ARE FEW IF ANY
MEANS TO STORE SUCH PERISHABLES EVEN IF ONE WANTED TO
HEDGE AGAINST PRICE INCREASES BY BUYING WHEN PRICE IS LOW.
OTHER LESS PERISHABLE GOODS (CANNED FOODS, CHEESE, TEA,
SUGAR, COOKING OIL) ARE NORMALLY BOUGHT THROUGH GOVERNMENT
STORES; UNLIMITED QUANTITIES OF SUCH GOODS ARE RARELY
AVAILABLE. IN SOME INSTANCES WHEN A PARTICULAR BARGAIN
IS AVAILABLE AND STORAGE PRESENTS NO PROBLEM, MOST
EGYPTIANS TAKE ADVANTAGE OF IT AND BUY WHATEVER THEY
CAN AFFORD. AGAIN SUCH OCCURRENCES ARE RARE. OTHER
ITEMS ARE GENERALLY IN SUCH SHORT SUPPLY THAT THE PROCESS
OF OBTAINING THEM (APPLICATION AND WAITING LISTS) DIS-
COURAGES MULTIPLE PURCHASES. LACK OF SUFFICIENT INCOME
IS, HOWEVER, PROBABLY GREATEST SINGLE DETERRENT TO
HOARDING. MOST EGYPTIAN WAGE EARNERS EARN BARELY ENOUGH
TO SUPPORT THEIR FAMILIES AND THEIR OWN GROWING DEMANDS
ON DAILY BASIS; THERE IS LITTLE LEFT OVER FOR SPECULA-
TIVE OR PROBLEM HOARDING.

--HOW SIGNIFICANT IS EFFECT OF CORRUPTION AND TO WHAT
EXTENT IS RESPONSIBILITY/BLAME FIXED IN PUBLIC
PERCEPTION?

ANY DISCUSSION OF CORRUPTION MUST BE IN STRICTLY RELATIVE
TERMS OF TRADITIONAL PUBLIC ACCEPTANCE OF IT AND WHAT
CHANGES MIGHT HAVE OCCURRED. THERE IS NO DOUBT CORRUPTION
IS A SIGNIFICANT POLITICAL ISSUE AND (BY WESTERN STAND-
ARDS) WIDESPREAD. IT IS GENERALLY BELIEVED THAT SADAT
FAMILY, SAYID MAREI, OSMAN AHMED OSMAN, ALI-SAWI AND
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OTHER MEMBERS OF "THE CLAN" ARE DEEPLY AND PROFITABLY
INVOLVED. GOVERNMENT'S FAILURE TO PROSECUTE ANY OF THE
MAJOR CORRUPTION CASES BROUGHT TO PUBLIC LIGHT DURING
THE PAST FIVE YEARS HAS REINFORCED BELIEF THAT THE LEADERS

MUST BE PROTECTING THEMSELVES.

PUBLIC REACTION IS ALREADY VOCAL, PARTICULARLY AMONG MARXISTS, NASSERISTS AND WESTERN-EDUCATED INTELLECTUALS WHO CLAIM CORRUPTION AND FAVORITISM ARE ROOT CAUSES OF PUBLIC DISSATISFACTION. EVEN ASU SYG CONSIDERS IT OF IMPORTANCE. EQUALLY DESTRUCTIVELY, MANY PERSONS IN POSITIONS OF RESPONSIBILITY BELIEVE THEY HAVE THE RIGHT TO EMULATE THE LEADERS. SINCE THERE IS ALSO MORE MONEY CHANGING HANDS, IT IS ALMOST CERTAIN THAT CORRUPTION IS ON A LARGER SCALE AND MORE PERVASIVE THAN HERETOFORE.

FRUSTRATION OF LOWER AND LOWER-MIDDLE CLASSES HAVE BEEN INTENSIFIED BY THE WIDESPREAD AVAILABILITY OF IMPORTED GOODS, RANGING FROM CANNED SOFT DRINKS TO COSMETICS AND FINE ENGLISH WOOLENS, AT PRICES ONLY VISITING ARAB SHEIKS, FOREIGNERS AND A SMALL MINORITY OF EGYPTIANS CAN AFFORD. PORT SAID FREE ZONE, INSTEAD OF CONTRIBUTING TO INDUSTRIAL DEVELOPMENT, IS WIDELY CONSIDERED TO BE A SMUGGLERS' PARADISE AND SOURCE OF LUXURY IMPORTS FOR THE WELL-TO-DO. EXASPERATED SADAT SUPPORTERS ONLY WISH THESE CONSUMER GOODS, WHICH ARE ALSO WIDELY ADVERTISED ON TV AND IN PRINT, WOULD BE SOLD SURREPTITIOUSLY.

NOTE: PROF. ABDOZ AZIZ SAID OF AMERICAN UNIVERSITY IS ENGAGED IN A STUDY ATTEMPTING TO DEMONSTRATE THAT CORRUPTION IN THE MIDDLE EAST IS A CULTURAL IMPERATIVE.

--DOES THE EMBASSY HAVE ANY FURTHER INFORMATION CONCERNING DIFFERING ECONOMIC CONDITIONS (AND BY EXTENSION, PERCEPTION OF THE PROBLEMS) WITHIN VARIOUS PARTS OF THE COUNTRY? IN TERMS OF IMMEDIATE POLITICAL IMPACT, TO WHAT EXTENT
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ARE PROBLEMS AND SOLUTIONS BASED ON CONDITIONS IN CAIRO
WHICH MAY NOT EXIST ELSEWHERE?

RURAL GOVERNORATES IN GENERAL ARE HAVING LESS OF A PROBLEM WITH FOOD SHORTAGES, PARTICULARLY IN SUPPLIES OF INDIGENOUS COMMODITIES. SHORTAGES OF FLOUR AND SUGAR HAVE HIT RURAL GOVERNORATES AS WELL, BUT NOT TO EXTENT AS IN CAIRO WHERE PROBLEM IS SEVERELY COMPOUNDED BY SIZE OF POPULATION AND LACK OF RESPONSIVENESS IN DISTRIBUTION SYSTEM.

FOR SEVERAL REASONS, RURAL AREAS HAVE ALSO SUFFERED LESS FROM IMPACT OF INFLATION. MITIGATING FACTORS INCLUDE HOME PRODUCTION OF MAJOR PORTION OF FOOD CONSUMED, THEREBY MINIMIZING RELIANCE ON CENTRALIZED ECONOMIC DISTRIBUTION SYSTEM. MOREOVER, EXPATRIATE TRANSFERS SINCE 1974, OF WHICH PROBABLY 20 - 25 PER CENT FIND THEIR WAY INTO RURAL AREAS, HAVE HAD SIGNIFICANT INFLUENCE ON RURAL DISPOSABLE INCOME, PARTICULARLY GIVEN SUBSISTENCE LEVEL EXISTENCE ALMOST UNIVERSALLY PREVALENT OUTSIDE OF URBAN CENTERS. THUS, MANY FARMERS PERCEIVE THEMSELVES AS BETTER OFF, DESPITE RISING PRICES BECAUSE THE INCREMENTAL FUNDS GIVE THEM NEW ACCESS TO MONETARY ECONOMY.

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CAIRO SERVES AS BELLWEATHER FOR POLITICAL REACTION TO ECONOMIC POLICIES. IN ADDITION, DETERIORATING CITY SERVICES, OVER-CROWDING AND PRESSURES OF URBAN ENVIRONMENT ARE FELT MORE ACUTELY IN CAIRO THAN ANYWHERE ELSE. AS JANUARY 1977 CASE ILLUSTRATES, ACTIONS IN CAIRO CAN ALSO INFLUENCE ACTIVITY IN OTHER URBAN AREAS--E.G., ALEXANDRIA, TANTA--BUT RURAL AREAS TEND TO BE MUCH LESS REACTIVE FOR MANY REASONS. IN ADDITION TO DIFFERENCE IN ECONOMIC PERCEPTIONS BETWEEN RURAL AND URBAN CENTERS, MOST RURAL AREAS LACK POLITICAL SOPHISTICATION, ORGANIZATION AND LEADERSHIP EFFECTIVELY TO STAGE A PROTEST THAT WOULD RADIATE OUTWARD AS THE EVENTS OF JANUARY 1977 IN CAIRO DID.

6. (PARA 4. THE IMPACT OF POLITICAL DEBATE.)

--HOW REPRESENTATIVE OF PUBLIC ATTITUDES ARE MEMBERS OF PEOPLES ASSEMBLY WHO CRITICIZE GOE POLICIES AND ACTIONS? CALIBER OF PA MEMBERS IS NOT UNIVERSALLY HIGH(50 PER CENT ARE NOMINALLY WORKERS AND PEASANTS) AND MEMBERS' VIEWPOINTS ARE NARROWLY FOCUSED ON PROBLEMS OF THEIR CONSTITUENTS. MP'S CRITICAL OF RISE IN PRICES AND DECLINE IN QUALITY OF EGYPTIAN LIFE ARE ALMOST CERTAINLY REFLECTING VIEWS OF MOST CONSTITUENTS. ON CORRUPTION, WE SUSPECT MP'S ARE LARGELY REPRESENTATIVE OF INFORMED PUBLIC OPINION. TONE OF RECENT CRITICISM IS PROBABLY MORE ACERBIC AND STRIDENT THAN THAT OF ELECTORATE AS A WHOLE. LEVEL OF SOME DEBATES HAS BEEN BARELY ABOVE GUTTER AND MANY EMBASSY CONTACTS PROFESS DISDAIN WITH ASSEMBLY MEMBERS.

NEWLY FORMED WAFD HAS EFFECTIVELY REPRESENTED GENUINE PUBLIC CONCERNS. PARTY HAS FOCUSED ALMOST EXCLUSIVELY
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ON ECONOMICS AND CORRUPTION. WAFD PARLIAMENTARY HEAD HELMI MURAD IS A TRAINED ECONOMIST AND HAS DEVOTED MOST OF HIS ATTENTION TO THIS FIELD. IN THIS, HE HAS BEEN ENCOURAGED BY NATIONAL LEADER SARRAGEDDIN, WHO SEES ECONOMY AS GOVERNMENT'S WEAKEST AREA.

INDEPENDENTS, BY AND LARGE, HAVE FOLLOWED WAFD'S EXAMPLE AND CONCENTRATED ON BREAD AND BUTTER ISSUES. INDEPENDENTS WITH WHOM WE HAVE TALKED VOICE CONCERN OVER REELECTION PROSPECTS AND RECOGNIZE THAT SUREST ROUTE TO REMAINING IN ASSEMBLY IS BY SATISFYING CONSTITUENT CONCERNS. THEY SEE LITTLE CAPITAL IN PURSUING IDEOLOGICAL COURSES.

SAME NOT TRUE FOR NASSERITES AND LEFT, BOTH OF WHOM HAVE ATTACKED SADAT FOR BREAKDOWN ARAB "SOLIDARITY" AND ATTENUATED TIES WITH BLOC. THESE ARE ISSUES OF MARGINAL CONCERN TO GENERAL PUBLIC, WHO STILL OVERWHELMINGLY BACK SADAT AND HIS PEACE INITIATIVE. LEFT'S FOCUS ON EXTERNAL MATTERS HAS UNDERMINED ITS CREDIBILITY AS DOMESTIC POLITICAL FORCE.

-- TO WHAT EXTENT HAS PEOPLES ASSEMBLY DEBATE STIMULATED DISCONTENT?

FAR FROM STIMULATING IT, THE EMERGENCE OF REAL OPPOSITION PARTIES AND THE INTENSITY OF DEBATE IN PA RESULTED LARGELY FROM GROWING PUBLIC DISSENT AND FRUSTRATION OVER ECONOMIC CONDITIONS. IT IS "THE" ISSUE IN EGYPT TODAY WHICH TOUCHES EVERY EGYPTIAN AND OPPOSITION ELEMENTS HAVE CONCENTRATED THEIR ATTACK ON ECONOMIC PROBLEMS WHERE THEY CONSIDER

GOE MOST VULNERABLE. PUBLIC DISSENT AND ASSEMBLY DEBATES ARE, HOWEVER, MUTUALLY REINFORCING AND MP'S ATTACKS HAVE FURTHER STIMULATED PUBLIC DISCONTENT. THIS IS PARTICULARLY TRUE IN CAIRO WHERE ASSEMBLY PROCEEDINGS ARE FOLLOWED WITH

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GREATER INTEREST THAN ELSEWHERE.

-- WERE POSITIONS TAKEN BY SALEM AND KAISOONI DEFENDING
GOE POLICY IN PA DEBATE COORDINATED WITH SADAT?

WE ASSUME "GOE POLICY" REFERRED TO IN REFERENCE QUESTION HAS TO DO WITH RECENT PRICE RISE DEBATE IN PA. IT WAS KAISOONI, NOT SALEM, WHO ARGUED THAT CASE. IN FACT, AS PREVIOUSLY REPORTED, ECONOMIC MINISTERS ARE ANNOYED AT WHAT THEY REGARD AS (A) NO MORE THAN TEPID SUPPORT BY SALEM AND (B) SALEM'S FAILURE TO DISCIPLINE HIS OWN PARTY MEMBERS IN PEOPLES ASSEMBLY. WE HAVE NO DEFINITIVE INFORMATION ON EXTENT TO WHICH KAISOONI'S COMMENTS, IN ANSWER TO PA CRITICS, WERE COORDINATED WITH SADAT. WE HAVE NO REASON TO BELIEVE, HOWEVER, THAT THERE WAS CLOSE AND CONTINUOUS CONSULTATION WITH SADAT DURING THE SEVERAL DAYS OF PERTINENT DEBATE. NEVERTHELESS, KAISOONI DOUBTLESS BELIEVED THAT THE POSITIONS HE WAS ADVOCATING WERE CONSISTENT WITH THE MISSION WITH WHICH HE HAD EARLIER BEEN TASKED BY SADAT TO PRESIDE OVER EGYPT'S ECONOMIC AFFAIRS.

-- IN CONVERSATION WITH VISITING NWC GROUP, SADAT INDICATED HIGH LEVEL OF PERSONAL INVOLVEMENT IN PRESENT GOE EFFORTS TO FIND SOLUTIONS. WE WOULD APPRECIATE EMBASSY'S
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EVALUATION OF HIS EFFECTIVENESS IN THIS ROLE, AS WELL AS ANY THOUGHTS ABOUT HIS PERSISTENCE AND POSSIBLE DIRECT INVOLVEMENT IN IMPLEMENTATION OF ANY POLICY DECISIONS.

SADAT REGULARLY VOICES CONCERN ABOUT EGYPT'S ECONOMIC PROBLEMS. IN PAST YEAR AND A HALF HE HAS BECOME MORE AWARE OF THEM THAN WAS PREVIOUSLY THE CASE. IN FACT, SOME FIVE WEEKS AGO, ON MARCH 22, SADAT HELD A SPECIAL MEETING OF THE ECONOMIC MINISTERS--FIRST SUCH MEETING SINCE THEY ASSUMED OFFICE--TO HEAR REPORT ON EGYPT'S CURRENT ECONOMIC DIFFICULTIES.

YET AWARENESS AND ACTIVE INVOLVEMENT IN SEEKING TO REMEDY THEM ARE TWO DIFFERENT THINGS. HAVING NO PARTICULAR EXPERTISE IN ECONOMIC OR FINANCIAL MATTERS, SADAT FOCUSES ONLY SPORADICALLY ON SUCH PROBLEMS. APART FROM GIVING GENERAL INSTRUCTIONS, SOMETIMES CONTRADICTORY, HE TENDS TO RELY ON HIS MINISTERS TO MANAGE ECONOMIC PROBLEMS. DURING PAST YEAR KAISOUNI HAS GRADUALLY BEEN ABLE TO HAVE MORE FREQUENT OPPORTUNITIES TO DISCUSS ECONOMIC ISSUES DIRECTLY WITH PRESIDENT. (SALEM IS KNOWN TO BE NOT ENTIRELY HAPPY ABOUT THIS.) KAISOUNI HAS TOLD US THAT SADAT HAS GENERALLY APPROVED HIS RECOMMENDATIONS, ALTHOUGH DEPUTY PRIMIN WAS NOT CERTAIN WHETHER THE PRESIDENT FULLY UNDERSTANDS THEM. KAISOUNI AND ECONOMIC TEAM ARE ALSO CONCERNED THAT SADAT SOMETIMES REVERSES HIS POSITION WHEN CONFRONTED BY POLITICAL FACTORS WHICH GENERALLY TEND WEIGH MORE HEAVILY WITH HIM THAN DO ECONOMIC CONSIDERATIONS. KAISOUNI'S RESIGNATION, WHETHER OR NOT IT IS EVENTUALLY WITHDRAWN, AND GROWING RUMBLINGS OF PUBLIC DISCONTENT TO RISING PRICES ARE ONCE AGAIN FORCING SADAT TO FOCUS ON INTERNAL PROBLEMS, INCLUDING ECONOMIC ONES. DOMESTIC PROBLEMS WERE IN FACT THE BULK OF HIS MAY 2

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SPEECH.

WERE SADAT TO USE FULL POWER OF HIS OFFICE TO TRY TO PUT ACROSS NEEDED ECONOMIC REFORMS, HE COULD PROBABLY OVERAWE THE PUBLIC AND PEOPLES ASSEMBLY. PRESCRIPTION WOULD PROBABLY BE TOUGH AND IT IS DEBATABLE WHETHER THAT WOULD HELP SADAT POLITICALLY ON HOME FRONT. ANY SUGGESTION OF DIRECT RESPONSIBILITY FOR RISING PRICES WOULD, IN OUR VIEW, HURT SADAT'S IMAGE AND SUPPORT FROM THE EGYPTIAN PUBLIC. MOREOVER, EGYPTIANS LIVE ON SUCH A MARGINAL LEVEL THAT THEIR CONCERNS ARE PRIMARILY OF THE IMMEDIATE

PRESENT, NOT THE FUTURE. SADAT'S EFFORTS IN PAST TWO YEARS PUBLICLY TO CALL UPON EGYPTIAN PEOPLE TO ACCEPT FIVE MORE YEARS OF AUSTERITY, WHILE NECESSARY, WENT OVER LIKE LEAD BALLOONS. HE IS NOW APPEALING TO PUBLIC FOR TWO MORE YEARS OF PATIENCE, BUT PROMISING FIXED PRICES ON BASIC COMMODITIES AND WAGE INCREASES IN ORDER TO EASE LOAD OF THE LABORER. AT SAME TIME, HE IS MAKING SPOT DECISIONS ON HIS TRAVELS THROUGH EGYPT WHICH INEVITABLY ADD NEW FINANCIAL BURDENS TO EGYPT'S ALREADY STRAINED BUDGET; E.G. "GREEN REVOLUTION" PLANS IN NEW VALLEY, NEW WATER PIPELINE FROM HURGHADA TO QUSAYR, TEN-DAY BONUS FOR GOVERNMENT EMPLOYEES, ETC. IT IS THESE VAGARIES, LARGELY POLITICALLY-MOTIVATED IN ALL LIKELIHOOD, WHICH CAUSE ECONOMIC MINISTERS TO DESPAIR AND MAKE IT DIFFICULT PURSUE A RATIONAL, CONSISTENT ECONOMIC REFORM PLAN. SHOULD BE BORNE IN MIND, HOWEVER, THAT EGYPTIANS LIVE ON HOPE, AT LEAST IN VIEW OF GOE LEADERSHIP; FOR THIS REASON GOVT BELIEVES IT EFFICACIOUS TO CONTINUE FREQUENT PUBLIC ANNOUNCEMENTS OF PROJECTS AND PROGRAMS OF FUTURE BENEFIT TO POPULACE, ALMOST REGARDLESS OF ECONOMIC REALITIES

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INVOLVED IN THOSE ACTIVITIES.

-- TO WHAT EXTENT HAS POLITICAL LIBERALIZATION CONTRIBUTED TO POLARIZATION OF PUBLIC ATTITUDES ON ECONOMIC ISSUES? ARE THERE INDICATIONS THAT SADAT MIGHT SEEK TO CURB ANY SUCH TENDENCIES BY SLOWING DOWN LIBERALIZATION PROCESS?

THE MOST DRAMATIC CHANGE IN THE INTERNAL SITUATION SINCE THE FALL OF 1977 PRIOR TO SADAT'S JERUSALEM TRIP (WHEN "MALAISE" WAS TALKED ABOUT IN MUCH THE SAME TERMS AS TODAY) IS THAT POLITICAL LIBERALIZATION HAS GONE FORWARD AT A PACE

FASTER THAN SOME MEMBERS OF THE GOVERNMENT HAD WISHED (PACE HAS BEEN LARGELY SET BY SADAT). THE NEW WAFD PARTY IS NOT A GOVERNMENT CREATION AND THE LEFTIST PARTY, WHICH WAS, IS NO LONGER. IN ADDITION THE OPPOSITION PAPERS AL-AHALI AND AL-AHRAR, EACH OF WHOM HAS A CIRCULATION ESTIMATED AT 100,000, ARE CONSIDERED BEST READING IN TOWN (AND WE ARE TOLD EVEN IN VILLAGES).

IF "POLARIZATION OF ATTITUDES" ON ECONOMIC ISSUES MEANS THE CONFLICT BETWEEN PROPONANTS OF ARAB SOCIALISM AND THE OPEN DOOR, THERE IS LITTLE DOUBT THAT LIBERALIZATION HAS RAISED THE LEVEL OF CRITICISM OF THE OPEN DOOR AND WIDENED THE GAP BETWEEN SUPPORTERS AND OPPONENTS.

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POLITICAL LIBERALIZATION HAS BEEN A MAJOR TENET OF SADAT'S POLICY BOTH BECAUSE HE BELIEVES IN IT AND AS A MEANS OF ESTABLISHING HIS OWN POWER BASE WHILE WEAKENING THOSE OF OTHERS. IT HAS WIDE PUBLIC SUPPORT, EVEN FROM SADAT'S CRITICS, BUT THE TIME HAD ALREADY COME BY LAST FALL WHEN THE NEW FREEDOMS BEGAN TO WORK AGAINST HIM AS CRITICISM MOUNTED. IT IS A MORE SERIOUS PROBLEM TODAY SINCE THE OPPOSITION IS ORGANIZED. THERE ARE SOME WITHIN THE GOVERNMENT AND AMONG CONSERVATIVE BUSINESSMEN (AND POSSIBLY THE MILITARY) WHO WOULD LIKE TO CRACK DOWN ON "GALLOPING DEMOCRACY." HOWEVER, LIBERALIZATION HAS PROBABLY COME TOO FAR TO BE REVERSED WITHOUT ENTAILING EVEN GREATER RISKS FOR THE GOVT., I.E. ANY ATTEMPT TO STIFLE IT COULD SERVE AS THE CATALYST TO BRING TOGETHER THE LEFT, RIGHT AND OTHER OPPONENTS IN THE NAME OF DEMOCRACY. THIS WOULD BE A SURE-FIRE ISSUE WITH STUDENTS AS WELL, AND PROBABLY THE LABOR UNIONS. ALTHOUGH RUMORS ABOUNDED THAT, IN HIS MAY 2 SPEECH, SADAT MIGHT CALL FOR REFERENDUM TO DISMISS PEOPLES ASSEMBLY, HE LIMITED HIMSELF TO A VEILED WARNING THAT IF OPPONENTS AND CRITICS WERE NOT MORE RESPONSIBLE, UNSPECIFIED STRONG MEASURES WOULD BE FORTHCOMING.

-- TO WHAT DEGREE CAN NEW WAFD BE EXPECTED TO EXPLOIT ECONOMIC PROBLEMS AND WHAT IMPACT MIGHT THIS DECISION HAVE?

NEW WAFD IS CERTAIN TO CONTINUE EXPLOIT ECONOMIC PROBLEMS, AS IT HAS VIGOROUSLY DONE IN RECENT PARLIAMENTARY DEBATES. WAFD LEADERS HAVE CONCLUDED THAT THEY HAVE ATTRACTIVE ISSUE AND ARE UNLIKELY LET GO. THIS IS EXPECTED BE CENTER PIECE OF UPCOMING BY-ELECTION IN ALEXANDRIA TWO WEEKS HENCE.

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FROM WHAT WE HAVE HEARD, WAFD IS OPERATING ON TWO LEVELS. IN PUBLIC, PARTY IS ON GOOD BEHAVIOR, OFFERING "CONSTRUCTIVE" ADVICE ON DOMESTIC MATTERS AND BACKING SADAT'S PEACE INITIATIVE FULLY. IN PRIVATE, WAFD LEADERS ARE HIGHLY CRITICAL OF GOVERNMENT PERFORMANCE ON BOTH FRONTS, FULLY EXPLOITING ECONOMIC SHORTCOMINGS.

IMPACT OF WAFD FOCUS ON ECONOMIC ISSUE DIFFICULT TO ASSESS. PARTY LACKS ITS OWN NEWSPAPER AND HAS DIFFICULTY PUBLICIZING ITS VIEWS. THREE (GOVERNMENT CONTROLLED) DAILIES HAVE LARGELY IGNORED WAFD ATTACKS. LEFTIST AL-AHALI AND RIGHT WING AL-AHRAR HAVE GIVEN WAFD SOME SPACE, BUT BOTH DEVOTE PRIMARY COVERAGE TO ACTIVITIES OF THEIR OWN PARTIES. UNTIL, AND UNLESS, WAFD DEVELOPS SOME MEANS OF REACHING PUBLIC DIRECTLY, IMPACT OF ITS POSITIONS WILL REMAIN LIMITED.

7. (PARA 5, CABINET MANEUVERS)

-- WHAT IS BASIS FOR SALEM'S CONTINUING HOLD ON SADAT?

SALEM'S BIGGEST ASSET IS THAT, DESPITE HIS HANDLING OF JAN. 1977 RIOTS, SADAT STILL PERCEIVES HIM AS A MAJOR SECURITY ASSET AND INTERNAL SECURITY IS UPPERMOST IN HIS (SADAT'S) MIND. SECONDLY, SADAT CONTINUES TO PLACE MAJOR IMPORTANCE IN CHOOSING HIS CLOSEST COLLABORATORS ON THEIR PERSONAL LOYALTY. SALEM OF COURSE PROVED HIS LOYALTY IN MAY 1971 BY ROLE IN THE ARREST OF ALI SABRI ET AL. HE HAS CONTINUED TO SERVE SADAT LOYALLY SINCE BEING APPOINTED PRIME MINISTER IN APRIL 1975. THIRDLY, SADAT DOES NOT EASILY DISPENSE WITH THOSE WHO HAVE SERVED HIM FAITHFULLY, PARTICULARLY WITHOUT FINDING THEM A SUITABLE POSITION. SADAT IS ALSO MOST COMFORTABLE WITH KNOWN AND FAMILIAR FACES IN KEY POSITIONS, FINALLY, THERE IS PROBLEM OF FINDING A SUCCESSOR AND AS

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NOTED BELOW A PARTICULAR DEARTH OF TALENT AT PM LEVEL.
UNTIL AN ADEQUATE SUCCESSOR AND AN HONORABLE WAY OUT FOR
SALEM CAN BE FOUND, WE EXPECT HIM TO STAY.

-- WHAT ARE ASSESSMENTS OF POTENTIAL REPLACEMENTS?

CONTRARY TO EARLIER EXPECTATIONS, SADAT SEEMS TO HAVE
DECIDED TO KEEP SALEM ON AS PRIMIN, AT LEAST FOR TIME BEING.
IT IS GENERALLY BELIEVED, HOWEVER, THAT A MORE DRASTIC
CABINET CHANGE WILL TAKE PLACE IN OCTOBER OR PERHAPS EVEN
BEFORE. IF SALEM'S PERFORMANCE HAS NOT IMPROVED BY THEN,
SADAT MIGHT DECIDE THAT HE SHOULD BE REPLACED.

IN THAT EVENT, MOST FREQUENTLY SUGGESTED NAMES ARE
MUSTAFA KHALIL, VP MUBARAK, GENERAL GAMASY AND ISMAIL
FAHMY (BY HIMSELF ONLY). MUSTAFA KHALIL IS IN THE INNER
CIRCLE OF DECISION-MAKERS TO THE EXTENT THAT SADAT SHARES
DECISION-MAKING POWER. HE IS BELIEVED TO BE INTERESTED
AS DEMONSTRATED BY ALACRITY WITH WHICH HE CRITICISES
SALEM AND OTHERS. HE CLAIMS HE CANNOT BECOME PRIME
MINISTER SINCE SALEM REFUSED TO ACCEPT HIM AS MEMBER
(AND DEPUTY DIRECTOR) OF MISR PARTY . WHEN AND IF HE
ENTERS PARTY WILL BE SIGNIFICANT.

GAMASY WOULD BE A LONG SHOT POSSIBILITY SINCE HIS APPOINT-
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MENT WOULD CARRY MANY RAMIFICATIONS FOR PEACE PROCESS AND
THE ROLE OF THE MILITARY. WE BELIEVE HE WOULD BE RELUC-
TANT TO TAKE THE JOB EXCEPT IN TIME OF NATIONAL CRISIS
AND WOULD IN ANY CASE BE POORLY EQUIPPED TO HANDLE GOE'S
HORRENDOUS ECONOMIC PROBLEMS.

A PARTIAL MILITARY CABINET WITH OR WITHOUT GAMASY WOULD
PROBABLY ONLY BE RESORTED TO UNDER MOST DRASTIC CIRCUM-
STANCES. SAME IS EVEN MORE TRUE FOR POSSIBILITY THAT
SADAT HIMSELF MIGHT AGAIN TAKE OVER PRIME MINISTERSHIP.
VP MUBARAK IS SLIGHTLY MORE LIKELY PROSPECT, BUT WE HAVE
NO EVIDENCE THAT HE INTERESTED. FAHMY HAS NO POLITICAL
BASE AND IS CONSIDERED DEFINITE LONG SHOT.

-- IS "ECONOMIC TEAM" UNDER FIRE BECAUSE OF ACTUAL SUCCESS
OF POLICY WHICH UNAVOIDABLY HAS RESULTED IN SHORT-TERM

ECONOMIC DISLOCATIONS, OR BECAUSE OF BASIC ECONOMIC
DETERIORATION (I.E., FAILURE OF THOSE POLICIES)?

REFORM POLICY HAS NEITHER SUCCEEDED NOR FAILED THUS FAR.
ECONOMIC TEAM IS UNDER FIRE BECAUSE OF ATTEMPTS TO RECTIFY
SITUATION, NOT ACTUAL SUCCESS ACHIEVED THUS FAR, AND
BECAUSE OF PERCEPTION WITHIN OTHER ELEMENTS OF GOE
LEADERSHIP THAT THESE ATTEMPTS HAVE CONTRIBUTED TO OR
CAUSED WIDELY-RECOGNIZED WAGE/PRICE DIFFICULTIES AND
ATTENDANT POLITICAL RUMBLINGS. TEAM'S ATTENTION TO NEED
FOR DELIBERATE PACE OF REFORMS BRINGS ITS SERIOUSNESS OF
PURPOSE UNDER QUESTION BY IMF, BUT AT SAME TIME IS CON-
SIDERED INSUFFICIENTLY FOCUSED ON POLITICAL REALITIES
BY MANY OF THEIR COLLEAGUES AND PA MEMBERS. MEANWHILE,
SUCH RELATIVELY LIMITED (BY IMF STANDARDS) MEASURES AS
ARE ENACTED BY KAISOUNI ET AL, PARTICULARLY IN PUBLIC
SECTOR PRICING FIELD, PLUS SUPPLY/DEMAND FACTORS GRADUALLY
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WORKING THEIR WAY THROUGH ECONOMY WHICH CAUSE RISING
COSTS TO CONSUMERS, OCCASION GENERAL DISSATISFACTION AND
CONCERN THAT IS DIRECTED LARGELY AGAINST THOSE MINISTERS
MOST DIRECTLY IDENTIFIABLE AS RESPONSIBLE FOR MANAGEMENT
OF ECONOMY. ECONOMIC MINISTERS ARE BEING BLAMED FOR
INFLATION DUE NOT ENTIRELY TO THEIR DECISIONS, BUT ALSO
AS CONSEQUENCE OF WORLD-WIDE PRICE RISES ONLY SOMEWHAT
RECENTLY AFFECTING EGYPT SERIOUSLY.

-- WHAT IS LINE-UP/INVOLVEMENT OF OTHER MEMBERS OF
CABINET ON IMF PROPOSALS FOR EGYPTIAN ECONOMIC POLICY?

ALTHOUGH THERE IS A GENERAL CABINET RECOGNITION OF GOE
NEED TO ARRIVE AT SOME ACCOMMODATION WITH IMF, THERE IS
WIDESPREAD DISPARITY AMONG THE CABINET MEMBERS ON THE
SPECIFICS OF IMF PROPOSALS. KAISOUNI AND TWO OF THE
ECONOMIC MINISTERS GENERALLY SUPPORT THE IMF PROPOSALS,
ALTHOUGH EVEN THEY CONTEND IMF IS ASKING TOO MUCH IN
TERMS OF PRICE RISES IN TOO SHORT A PERIOD. THESE TWO
ARE MINECON HAMED EL SAYEH AND MINFIN SALADIN HAMED.
FOURTH MEMBER OF ECONOMIC GROUP, MIN TRADE/SUPPLY
ZAKARIA TEWFIK, CLAIMS NOT TO BE OPPOSED TO PRICE RISES,
BUT BELIEVES THEY SHOULD HAPPEN ON A MORE GRADUAL
BASIS. IN PRODUCTION SECTOR, MINPET/INDUSTRY, CONSISTENT
WITH IMF PROPOSALS, HAS ALLOWED SOME PRICE RISES IN
CERTAIN INDUSTRIAL PRODUCTS. SIMILARLY, IN SERVICES
SECTOR, MINHEALTH IBRAHIM BADRAN HAS ALLOWED PRICE RISES
IN PHARMACEUTICALS. DEPUTY PRIME MINISTER ELECTRICITY
AHMED SULTAN IS ALSO ALLOWING MODEST PRICE RISES IN COST
OF ELECTRICITY.

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REST OF CABINET RANGES FROM THOSE WHO GIVE LIP SERVICE TO ACCEPTING IMF PROPOSALS, I.E. PRICE RISES, BUT ARGUE FOR MORE GRADUALIST APPROACH, TO THOSE WHO OPENLY CRITICIZE IMF RECOMMENDATIONS AS RECIPE FOR POLITICAL CATASTROPHE. DEP PRIMIN GHANEM STRONGLY OPPOSED IMF RECOMMENDATIONS ON GROUNDS THAT THEY ARE CERTAIN TO BRING DOMESTIC POLITICAL PROBLEMS. GHANEM CONCEDES HE HAS NO ECONOMIC EXPERTISE AND THAT ECONOMIC REFORM IS BADLY NEEDED. AT SAME TIME HE EXPRESSES DEEP CONCERN ABOUT EFFECT RISING PRICES ARE HAVING ON MORALE OF MILITARY, MILITARY DEPENDENTS AND GENERAL PUBLIC. DEP PRIMIN GAMASY ECHOES THIS CONCERN; HE ACKNOWLEDGES NEED IN GENERAL FOR REFORM, BUT NATURALLY IS UNHAPPY ABOUT PRICE RISES AND THEIR EFFECT ON LIVING STANDARDS OF MILITARY. MINISTER OF STATE ISSA SHAHIN ALSO OPPOSES PRICE RISES.

PRIMIN SALEM GIVES LIP SERVICE TO NEED FOR PRICE RISES, BUT HAS PREFERRED TO LET KAISOUNI AND THE ECONOMIC MINISTERS CARRY THE BURDEN IN THE CABINET AND THE PEOPLES ASSEMBLY. HIS SUPPORT FOR NEEDED PRICE RISES IS AT BEST TEPID.

-- IS KAISOUNI REAL TARGET FOR DISCONTENT OR MERELY SCAPEGOAT?

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KAISSOUNI IS A REAL TARGET FOR CRITICISM IN PA, CABINET AND CERTAIN SEGMENTS OF EDUCATED SOCIETY, BUT IS NOT UNDER ATTACK BY PUBLIC AT LARGE. DISSATISFACTION OF POPULACE WITH DECLINING STANDARDS OF LIVING, ALREADY LOW FOR MOST, IS MORE GENERALIZED AND IS DIRECTED AT GOVERNMENT AS A WHOLE, INCLUDING SADAT; KAISSOUNI IS NOT ALL THAT IDENTIFIABLE TO MOST AS ARCHITECT OF REFORM MOVES LEADING TO HIGHER PRICES. WE BELIEVE QUESTION OF WHETHER KAISSOUNI IS TO BE USED AS SCAPEGOAT BY SADAT IS MOOT AT PRESENT. WE UNDERSTAND THAT HE AND ALL MEMBERS OF ECONOMIC GROUP HAVE BEEN ASKED TO STAY ON. KAISSOUNI IS NOW EXPECTED TO STAY IN OFFICE UNTIL AT LEAST AFTER IBRD CONSULTATIVE GROUP MEETING NEXT MONTH. HIS EVENTUAL DEPARTURE AT LATER DATE FOR WHATEVER REASON NEVERTHELESS COULD BE ACCOMPANIED BY GOVERNMENT ANNOUNCEMENTS DESIGNED TO ACCENTUATE POSITIVE ON HIS REPLACEMENT (OR REPLACEMENTS), THUS BY IMPLICATION PUSHING OFF SOME BLAME ON HIM FOR WAGE/PRICE SQUEEZE AND ANY UNPOPULAR MEASURES RECENTLY ENACTED.

8. (PARA 6. OPTIONS AND PROSPECTS)

--WHAT MEASURES ARE FEASIBLE IN DEALING WITH CURRENT SITUATION?

EVEN INTERPRETED NARROWLY (NOT AS A GENERAL QUERY ON "WHITHER EGYPT" ECONOMICALLY) THIS IS TRULY THE 64 DOLLAR QUESTION. GOE PERCEPTIONS OF WHAT IS FEASIBLE ARE DIVIDED, WITH KAISSOUNI FACTION MORE FORTHCOMING ON PENDING REFORM MEASURES THAN MOST OF CABINET AND SENIOR OFFICIALS. IMF AND, TO LESSER EXTENT, IBRD TAKE HARDER LINE ON VARIOUS STEPS NEEDED, ALTHOUGH THIS POSITION IS NOT, IN VIEW OF EXPERIENCE WITH JANUARY RITS AS DOC-

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TRINAIRE AS IT WAS WHEN STANDBY NEGOTIATION PROCESS BEGAN TWO YEARS AGO. EMBASSY HAS AMBIVALENT FEELINGS ON SUBJECT OF REFORM: WELL-KNOWN POLITICAL CONSIDERATIONS DICTATE APPROACH TO QUESTION WHICH WILL NOT BE DISRUPTIVE OF PEACE PROCESS, BUT AT SAME TIME WELL-RECOGNIZED ECONOMIC DISTORTIONS IN SYSTEM VIRTUALLY REQUIRE A BEGINNING TO SERIOUS REMEDIAL EFFORTS AS PRE-CONDITION TO LONGER-RANGE DEVELOPMENT ACTIVITIES.

(NOTE: POLCOUNS STRONGLY ARGUES FOR A MORITORIUM THROUGH 1978 ON REFORMS THAT WOULD RAISE PRICES AND HE ADVOCATES ADDITIONAL SHORT-TERM ASSISTANCE FROM ALL DONORS, INCLUDING IMMEDIATE INCREASE IN CIP PROGRAM OF \$100 MILLION. HIS POSITION IS BASED ON CONVICTIONS THAT 1978 IS THE CULMINATION OF PEACE PROCESS. BY DECEMBER IT

WILL BE CLEAR TO EGYPTIAN PUBLIC WHETHER PEACE IS IMMINENT OR NOT. IF IT IS, REGIME WILL BE POLITICALLY STRONG ENOUGH TO MAKE NEEDED REFORMS. IF PEACE NOT IMMINENT, REGIME WILL STILL HAVE TO TAKE THESE DECISIONS REGARDLESS OF RISKS. NEXT EIGHT MONTHS ARE CRUCIAL AND ALL DONORS SHOULD DO WHATEVER POSSIBLE TO ALLEVIATE SADAT'S ECONOMIC PROBLEMS.)

PRECISE IDENTIFICATION OF THOSE MEASURES WHICH ARE POSSIBLE THEREFORE AT ANY GIVEN TIME IS AT DISPUTE, AND ANY ENACTED AFFECTING CONSUMERS IN EGYPTIAN SOCIETY (E.G., PRICING QUESTIONS BEARING ON SUBSIDIES) TEND TO TEST LIMITS OF THE POLITICALLY ACCEPTABLE. FUNDAMENTAL REQUIREMENT IS THAT GOE THROUGH COORDINATED SET OF POLICY DECISIONS ARRIVE AT POSITION OF CONSIDERABLY REDUCED DRAIN ON RESOURCES IN FORM OF CONSUMER SUBSIDIES. OTHER MACROECONOMIC NEEDS, INCLUDING BETTER RESOURCE MOBILIZATION FOR

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DEVELOPMENT PURPOSES, FLOW FROM THAT BASIC NECESSITY.

WE NOTE, HOWEVER, THAT GOE AND IMF ARE NOT FAR APART AT THIS TIME AND THAT TALKS ON AN IMF CREDIT HAVE RESUMED. NATURE OF THIS GIVE-AND-TAKE PROCESS, WITH DIFFERING IMPORTANT ECONOMIC-POLITICAL CONSIDERATIONS REPRESENTED AND RECEIVING CLOSE ATTENTION BY THE TWO PROTAGONISTS, ESPECIALLY ON QUESTION OF TIMING OF PROPOSED MOVES, IS SUCH THAT FINAL SET OF GOE CONCESSIONS, WITH OR WITHOUT FORMAL AGREEMENT, PROBABLY WILL BEST DEFINE THE FEASIBLE AS SEEN BY THOSE MOST DIRECTLY CONCERNED--GOE LEADERSHIP--AT THIS TIME. THERE IS LIMIT TO WHICH WE CAN TRY TO PRESCRIBE PACE AND DETAILS OF REFORMS TO THOSE PRESUMABLY BEST ABLE TO JUDGE REACTION OF POPULACE TO

MEASURES, WHICH UNAVOIDABLY WILL STILL MORE ADVERSELY AFFECT OVER SHORT RUN ALREADY DEPRESSED EGYPTIANS STANDARD OF LIVING.

CONVENTIONAL WISDOM, SUPPORTED MORE OR LESS BY ECONOMIC GROUP AND MEMBERS OF GOVERNMENT WHO ARE KNOWLEDGEABLE ABOUT ECONOMIC ISSUES, NONETHELESS HOLDS THAT CERTAIN PRICE REFORMS MUST BE UNDERTAKEN IN PUBLIC SECTOR AS STEP TOWARD INTERNAL RATIONALIZATION. KAISSOUNI'S LE 150 MILLION REDUCTION IN "HIDDEN SUBSIDIES" IN PUBLIC SECTOR OPERATIONS, PLUS ANNOUNCEMENT THAT PRICE INCREASES
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WILL BE PASSED ON TO PURCHASERS, IS BEST RECENT EXAMPLE OF GOE EFFORTS TO MOVE ON INTERNAL ECONOMIC REFORMS. ADDITIONALLY, TAXATION CHANGES ARE ALSO REQUISITE TO ASSURE MORE EQUITABLE DISTRIBUTION OF INCOME AND SUPPORT, IN SOME MEASURE, GOVERNMENT'S AMBITIOUS INVESTMENT PLAN. DESPITE THIS, GOE HAS UNSUCCESSFULLY (TO DATE) ATTEMPTED TO PUSH REFORMS THROUGH ROADBLOCK OF PEOPLES ASSEMBLY. UNCONTROLLED PRICES, ON OTHER HAND, HAVE RISEN SO RAPIDLY IN MOST SECTORS OF ECONOMY (IN LARGE MEASURE DUE TO IMPORTED INFLATION PLUS PENT-UP CONSUMER DEMAND) THAT THESE HAVE BECOME POLITICAL ISSUE FOR MASSES. GOE THUS ALSO MUST IMPLEMENT PUBLIC SECTOR WAGE INCREASE IN COURSE OF YEAR TO AT LEAST CREATE ILLUSION THAT SOME EFFORT BEING MADE TO RELIEVE POPULACE OF INFLATIONARY BURDEN.

-- IF SADAT RESORTED TO CABINET CHANGES, WOULD HE PERCEIVE THIS TO BE SOLUTION OR RATHER AS MEANS OF INCREASING THE COMPETENCE OF GOVERNMENT TO HANDLE PROBLEMS?

JUDGING BY PREVIOUS CABINET CHANGES, ,F WHICH THERE HAVE BEEN SIX SINCE OCTOBER WAR, WE BELIEVE SADAT PERCEIVES THEM TO BE PARTIAL SOLUTION TO CURRENT POLITICAL PROBLEMS; I.E. TO SILENCE CRITICS, RAP KNUCKLES AND BUY TIME. WHILE LIP SERVICE GIVEN TD INCREASING COMPETENCE, THIS APPEARS TO BE SECONDARY CONSIDERATION. WE DOUBT THAT SADAT SEES CABINET CHANGE AS MEANS OF RESOLVING MAJOR PROBLEMS. CERTAINLY TO DATE NO ONE ELSE HAS. IN .
UNLIKELY EVENT SADAT WERE TO DECIDE TO ATTACK FORCEFULLY MAJOR PROBLEMS, HE IS QUITE CAPABLE OF FULL SCALE CHANGE IN CABINET COMPLEXION AND MAKEUP. SADAT LIKES THE DRAMATIC, AND THIS COULD HAPPEN IF PEACE SETTLEMENT REACHED OR IF PROCESS COLLAPSES.

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-- WHAT INDICATIONS ARE THERE, IF ANY, CONCERNING POSSIBLE
SHIFTS IN BASIC GOE ECONOMIC POLICY?

THERE ARE NO SIGNIFICANT SIGNS THUS FAR THAT GOE'S BASIC
ECONOMIC POLICIES, THAT IS, PROMOTION OF OPEN DOOR WITH
ATTENDANT REFORMS (AT A MEASURED PACE, TO BE SURE), ARE
UNDERGOING CHANGE AS RESULT OF RECENT DOMESTIC DIFFICUL-
TIES. SADAT SPEECH MAY 2, WHILE ACKNOWLEDGING INCOME
DISTRIBUTION DISPARITIES ARISING FROM OPEN DOOR, CONTAINED
NO HINT OF PLANNED REVERSAL OF COURSE. SHIFT TO LIBER-
ALIZED ECONOMY IS INTEGRAL PART OF BROADER SADAT-INSPIRED
CHANGE IN ORIENTATION FROM EAST TO WEST, FROM SOVIET UNION
TO U.S., FROM SOCIALIST PLANNED TO MIXED ECONOMY, FROM A
NASSER POLITICAL FOCUS TO ONE CENTERED ON SADAT HIMSELF.
CRITICISMS OF (ESPECIALLY) PRICE AND SUBSIDY ASPECTS OF
REFORMS HAVE CAUSED GO-SLOW ATTITUDES, AND SOME FEW
PROTECTIONIST TRADE MEASURES HAVE BEEN ENACTED BY GOE IN
PAST MONTHS, BUT FAILING A FUNDAMENTAL MODIFICATION OF A
SADAT-LED GOVERNMENT'S GENERAL POLITICAL/ECONOMIC POSTURE
WE DO NOT EXPECT ANY CHANGES IN BASIC ECONOMIC DIRECTION.
WHAT REMAINS ILL-DEFINED AND THEREFORE VARIABLE ARE
DELINEATION IN DETAIL OF GENERAL POLICY IN ECONOMIC REALM
AND SPECIFICS OF PROGRAM IMPLEMENTATION. AS TO REFORM,
GOE NONETHELESS IS EXPECTED TO CONTINUE TO WORK WITH IMF
ON VARIOUS ASPECTS OF JOINTLY AGREED PROGRAM, ALTHOUGH
TIMING OF MEASURES TO BE UNDERTAKEN, IF GOE HAS ITS WAY,
WILL DEFINITELY BE GRADUAL.

-- ARE POLITICAL PRESSURES SUCH THAT SADAT PER FORCE WILL
GO SLOWLY IN IMPLEMENTING ECONOMIC REFORMS?

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YES, POLITICAL CONSIDERATIONS, ALWAYS PARAMOUNT, ARE PARTICULARLY COMPELLING IN THIS CONNECTION AFTER JANUARY 1977 EVENTS.

-- IF ECONOMIC TEAM IS REPLACED, WHO ARE LIKELY CANDIDATES, AND WHAT ARE THEIR RESPECTIVE TALENTS/PROSPECTS?

SADAT APPARENTLY HAS DECIDED THAT KAISOUNI WILL STAY IN HIS PRESENT POSITION AS DEPUTY PRIME MINISTER AND WE HEAR (FROM MINECON EL SAYEH) THERE WILL BE NO IMMEDIATE CHANGES AMONG OTHER MEMBERS OF ECONOMIC GROUP. IT MAY BE NOTED THAT EL-SAYEH AND SALAH HAMED HAVE HAD LONG ASSOCIATION WITH KAISOUNI AND WERE SELECTED BY HIM IN NOVEMBER 1976 AS TRUSTED COMPETENT ASSOCIATES WITH WHOM HE WOULD CARRY OUT NEW ECONOMIC POLICY. BOTH HAVE PROVED TO BE REASONABLY ADEPT AT THEIR JOBS. NEITHER HAS BEEN CHARGED WITH CORRUPTION, AS FAR AS WE ARE AWARE. MOST OF RECENT PA AND CABINET CRITICISM, MOREOVER, HAS BEEN LEVELED AGAINST KAISOUNI AND HIS GENERAL "POLICY", MEANING MAINLY HIS APPROACH TO PUBLIC SECTOR PRICE RATIONALIZATION. RETAINING KAISOUNI, THEREFORE, MEANS IMPLICIT ENDORSEMENT OF HIS PERFORMANCE AND GENERAL OUTLOOK. SADAT WOULD NOT NECESSARILY, IN OUR EYES, GAIN ANY POLITICAL POINT OR IMPROVE PERFORMANCE BY ELIMINATING OTHER MEMBERS OF HIS ECONOMIC GROUP AT ANY TIME SOON.

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ONE MEMBER OF ECONOMIC GROUP WHO WOULD PROBABLY LIKE TO BE RELIEVED OF SOME OF HIS RESPONSIBILITIES, HOWEVER, IS MINTRADE AND SUPPLY TEWFIK; HE WANTS TO SHED BURDENSOME SUPPLY PORTFOLIO, ORSO WE HEAR. THIS OF COURSE WOULD BE POSSIBLE WITHOUT CHANGE IN ORIENTATION OF GROUP. WE ALSO INCLUDE FOR PURPOSE OF THIS MESSAGE MINISTERS OF INDUSTRY, AGRICULTURE, IRRIGATION AND TOURISM IN ECONOMIC GROUPING BECAUSE OF THEIR IMPORTANCE IN ACHIEVING ECONOMIC DEVELOPMENT GOALS.

IF FOR SOME REASON PRESIDENT OR PRIME MINISTER FELT IT NECESSARY TO FORCE KAISOUNI TO REPLACE HIS ECONOMIC MINISTERS AT SOME FUTURE TIME (E.G., PRIME MINISTER MIGHT PERHAPS WISH TO GAIN MORE CONTROL OVER KAISOUNI), THEN FOLLOWING ARE PERSONS WHO MIGHT BE SELECTED TO REPLACE CURRENT MINISTERS OF ECONOMICS, FINANCE, PLANNING, SUPPLY AND/OR INDUSTRY. (AGRICULTURE, IRRIGATION AND TOURISM ARE TREATED SEPARATELY.) BECAUSE PRIME REQUISITE FOR JOB UNDER THIS SCENARIO (WHICH WE BELIEVE TO BE UNLIKELY ANY TIME SOON) WOULD BE LOYALTY TO PRIME

MINISTER, THERE MAY BE PERSONS WHO HAVE NOT YET COME TO OUR ATTENTION; LIST IS NOT EXHAUSTIVE THEREFORE (INDICATED IN PARENTHESIS ARE POSTS INDIVIDUAL LIKELY FILL.)

A. SHARIF LUTFI (PROBABLY QUALIFIED TO HOLD ANY OF THE PORTFOLIOS.) LUTFI WAS REPORTEDLY OFFERED JOB OF MINISTER OF ECONOMIC COOPERATION IN CABINET FORMED IN NOVEMBER 1976, WHEN KASSOUNI CAME TO CABINET, BUT TURNED IT DOWN IN FAVOR OF FINISHING OUT HIS CONTRACT AS ECONOMIC ADVISER IN OMAN. LUTFI IS STRONG SUPPORTER OF OPEN DOOR POLICY AND OF ECONOMIC LIBERALIZATION. HE WAS SECRET

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UNCEREMONIOUSLY RELIEVED OF HIS POST AS FIRST HEAD (SUB MINISTERIAL) OF FLEDGLING ECONOMIC AND ECONOMIC COOPERATION ORGANIZATION IN MID-1974 BECAUSE HIS DRAFT OF NEW INVESTMENT LAW WAS CONSIDERED TOO LIBERAL BY THEN CABINET CHIEF HEGAZI. THOSE WHO HAD CONTACT WITH HIM IN FEW MONTHS OF HIS PREVIOUS RESPONSIBILITY KNEW HIM AS COMPETENT AND DEDICATED TO JOB OF GETTING EGYPTIAN ECONOMY MOVING. HIS ABILITY TO DO SO HAS NOT OF COURSE BEEN PROVED, BUT HE HAS BEEN MENTIONED IN ALMOST EVERY CABINET RESHUFFLE AS CANDIDATE FOR ONE OF THE JOBS IN THE ECONOMIC GROUP.

B. GAMAL AL-NAZAR (ECON/ECON COOP, PLANNING OR SUPPLY.) AL NAZAR IS WELL KNOWN TO US AS CURRENT COORDINATOR FOR U.S. ASSISTANCE AND DEPUTY DIRECTOR (CHIEF EXECUTIVE OFFICER) OF INVESTMENT AUTHORITY. HE HAS BEEN ASSOCIATED WITH OPEN DOOR POLICY EVER SINCE HE WAS OFFICE DIRECTOR FOR SHARIF LUTFI IN 1974. NAZAR LANDED ON HIS FEET THROUGH VARIOUS CHANGES IN MINISTRY OF ECONOMY AND NOW, WE BELIEVE, COULD FILL BILL AS QUALIFIED, ABLE TECHNOCRAT WHO HAS CONTINUITY AND IS KNOWN INTERNATIONALLY.

C. DR. AHMAD KAMEL AL-GANZOURI (PLANNING.) GANZOURI WAS RECENTLY APPOINTED BY KASSOUNI TO HEAD UP THE LONG MORIBUND PLANNING INSTITUTE. HE HAS GOOD REPUTATION AND MIGHT BE LIKELY CANDIDATE TO RELIEVE KASSOUNI OF HIS PLANNING PORTFOLIO.

D. MUHAMMAD IBRAHIM AL-DAKROURI (SUPPLY.) DAKROURI IS CURRENTLY A MEMBER OF PARLIAMENT (MISR PARTY) AND IS HEAD OF THE PA'S ECONOMIC COMMITTEE. HE HAS BEEN MENTIONED BY

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MINISTER EL-SAYEH AS POSSIBLE REPLACEMENT FOR TEWFIK AS
SUPPLY MINISTER.

FOLLOWING SCENARIO OF KAISSOUNI'S CONTINUATION, AND IF
HE WERE TO BE IN ON THE CHOICE FOR REPLACEMENTS IN
MINISTERIAL GROUP, HE MIGHT ALSO CHOOSE SOME PERSONS OF
LESSER RANK WHO HAVE BEEN ASSOCIATED WITH HIM OVER PAST
YEAR AND A HALF, INCLUDING HIS PRINCIPAL ADVISER FOUAD
HUSSEIN (WITH RANK OF DEPUTY MINISTER) AND FORMER CENTRAL
BANK DEPUTY GOVERNOR ABDEL MONEIM EL-BANNA (NOW WITH
ISLAMIC BANK), BOTH OF WHOM ARE TECHNICALLY QUALIFIED
IN ECONOMIC FIELD. OTHER POSSIBLE CANDIDATES, ALTHOUGH
LESS LIKELY TO APPEAR IF KAISSOUNI HAS PART IN CHOICE,
WOULD BE FORMER MINISTER OF PLANNING ABD AL RAZAK ABD
ABDEL MEGUID (NOW WITH UN BUT ANGLING AGAIN FOR CABINET
JOB), FORMER INVESTMENT AND FREE ZONE DEPUTY CHAIRMAN
ABD AL-MONIM ROUSHDI (CURRENT CHAIRMAN OF NATIONAL BANK)
AND WAGIH SHINDY, FORMER UNDER SECRETARY, MINISTRY OF
ECONOMY (NOW CHAIRMAN ARAB INVESTMENT BANK).

AS FOR MINISTER OF INDUSTRY, WE DOUBT THAT ANY REPLACEMENT
OTHER THAN FORMER MINISTER ISA SAHEEN WOULD BE LIKELY.
MINISTER HILAL IS QUALIFIED AND PROBABLY, IF GIVEN A
CHANCE, CAN TURN AROUND POOR PERFORMANCE OF THIS MINISTRY
(ALTHOUGH WE HAVE HEARD THAT HE WOULD PREFER TO CONCENTRATE
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ON PETROLEUM MATTERS, GIVING UP INDUSTRY). IF CHANGE TO
BE MADE, HOWEVER, SAHEEN HAS ENOUGH FRIENDS (SADAT, SALEM)
THAT HE LIKELY WOULD BE ABLE TO REGAIN POST, NOTWITH-
STANDING HIS ABYSMAL TRACK RECORD.

WITH PRESIDENT'S CURRENT EMPHASIS ON GREEN REVOLUTION, IT IS ALSO POSSIBLE THAT CABINET CHANGES COULD INCLUDE MINISTRIES OF AGRICULTURE AND, ALTHOUGH LESS LIKELY, IN IRRIGATION. MINISTRY OF AGRICULTURE HAS UNDERGONE NUMEROUS SHIFTS SINCE 1973 AS SADAT TRIED TO GET AGRICULTURAL RECLAMATION PROGRAM SPEEDED UP; HE HAS NOT YET SUCCEEDED. PRIME CANDIDATE FOR JOB IF MINISTER SHUKRY STEPS DOWN IS DEPUTY MINISTER SAAD HAGRASS. A MEMBER OF PEOPLES ASSEMBLY AND CHAIRMAN OF THAT BODY'S AGRICULTURE COMMITTEE, HAGRASS IS ALSO AN ACTIVE MEMBER OF MISR SOCIALIST PARTY, ALL OF WHICH MIGHT MAKE HIM ATTRACTIVE CANDIDATE. MINISTER OF IRRIGATION ABU AL-ATTA HAS BEEN IN CABINET SINCE APRIL 1975 AND IS TECHNICALLY QUALIFIED; IF HE WERE TO BE REPLACED IT WOULD BE WITH TECHNOCRAT FROM SAME MINISTRY.

AS FOR MINISTER OF TOURISM, THIS IS TRADITIONALLY A CABINET POSITION ALLOCATED TO COPT COMMUNITY. MINISTER STINO HAS BEEN OUTSPOKEN RECENTLY IN HIS DEFENSE OF CONTROVERSIAL PYRAMIDS PLATEAU PROJECT. AS THIS MATTER HEATS UP, SALEM MIGHT WELL LOOK AROUND FOR REPLACEMENT TO TAKE SOME POLITICAL HEAT OFF CORRUPTION ISSUE BY PUTTING BLAME ON STINO. ALTHOUGH TOURIST PROJECTS ARE IMPORTANT, THIS HAS BEEN TRADITIONALLY A TECHNICALLY WEAK MINISTRY AND NOT MUCH FRESH TALENT IS VISIBLE.

ALTHOUGH WE, ALONG WITH MANY OTHERS, WONDERED WHEN KAISSOUNI WAS NAMED TO HIS POST IF HE AND NEW FACES
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AROUND HIM WERE CAPABLE OF DOING JOB (KAISSOUNI HAD BEEN OUT OF GOVERNMENT SINCE 1968 AND SALAH HAMED WAS UNKNOWN TO US, HAVING BEEN RECRUITED FROM THE GULF), CERTAINLY KAISSOUNI, AND TO LESSER EXTENT OTHER MINISTERS, HAS PROVED TO BE ALMOST IRREPLACEABLE AT THIS JUNCTURE. HIS CONDUCT OF RELATIONS WITH INTERNATIONAL FINANCIAL INSTITUTIONS AND WITH OTHER DONORS, MOST IMPORTANT OF WHICH ARE ARABS OF THE PENINSULA AND GULF, IS VITAL IN KEEPING EXTERNAL FINANCING IN ITS CURRENT RELATIVELY GOOD STATE. THANKS IN LARGE PART TO GODE LARGESSE, KAISSOUNI HAS PRESIDED OVER CONSIDERABLE IMPROVEMENT IN EGYPT'S BALANCE OF PAYMENT AND MOST DONORS BELIEVE IN HIS COMMITMENT TO REFORMING THE EGYPTIAN ECONOMY. SUCH REPUTATION WOULD BE HARD TO REPLACE AND WE BELIEVE WILL NOT BE DONE LIGHTLY NOW OR IN THE FUTURE.

STILL IN WINGS, HOWEVER, ARE TWO OTHER DEPUTY PRIME MINISTERIAL CANDIDATES WHO TURNED PRESIDENT SADAT AND MAMDUH SALEM DOWN WHEN OFFERED KAISSOUNI'S JOB (BEFORE KAISSOUNI) IN NOVEMBER 1976. THEY ARE DR. ALI GRETLI AND

MOUSTAFA KHALIL. IN EVENT KAISSOUNI DECIDES IRREVOCABLY TO LEAVE OR HIS RESIGNATION IS ACCEPTED, SOONER OR LATER, EITHER WOULD BE ACCEPTABLE CHOICES FOR THE JOB OF DEPUTY PRIME MINISTER. AS MEASURE OF SHALLOWNESS OF TALENT POOL AT THAT LEVEL, IT IS DIFFICULT TO THINK OF ANYONE ELSE OF THEIR STATURE, AND IT IS NOT CLEAR THAT EITHER WOULD TAKE ON KAISSOUNI JOB IF OFFERED AGAIN. GRETLI IS CONSIDERED BY MOST TO BE OVERAGED FOR JOB, AND KHALIL QUITE POSSIBLY WOULD NOT ACCEPT POSITION UNDER SALEM. BOTH OF THESE MEN UNDOUBTEDLY ALSO HAVE THEIR OWN LISTS OF LOYAL COMPETENT COLLEAGUES AS BASIS FOR THEIR CHOICES FOR MINISTERS OF THEIR GROUP IF THEY WERE TO BE ASKED AND ACCEPTED; HOWEVER, THESE ARE NOT KNOWN TO US IN DETAIL AT THIS TIME.

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C O R R E C T E D C O P Y (PREVIOUSLY GARBLED THROUGHOUT)

9. (PARA 7. INTERNATIONAL ASPECTS)

-- WHAT IS LIKELIHOOD THAT PRESENT ECONOMIC DIFFICULTIES WILL ADVERSELY AFFECT SADAT'S APPROACH TO PEACE NEGOTIATIONS?

WE DO NOT BELIEVE SADAT WAS MOTIVATED BY ECONOMIC PROBLEMS TO TAKE HIS INITIATIVE NOR THAT THEY WILL SIGNIFICANTLY AFFECT HIS APPROACH TO NEGOTIATIONS. THE SEARCH FOR PEACE AND THESE PROBLEMS ARE MUTUALLY REINFORRING. MOST EGYPTIANS BELIEVE EGYPT'S ECONOMIC FUTURE DEPENDS UPON PEACE AND STRONG POPULAR SENTIMENT PUSHES SADAT TO MAINTAIN THE EFFORT. IF CIVIL DISTUBANCES AND A SERIOUS BREAKDOWN OF PUBLIC ORDER SHOULD OCCUR, THERE WOULD PROB-

ABLY BE AN EVEN GREATER URGENCY ON HIS PART TO MOVE THE NEGOTIATIONS FORWARD, BUT NOT NECESSARILY TO NEW CONCESSIONS. ANOTHER WAY IN WHICH ECONOMIC CONDITIONS COULD AFFECT THE NEGOTIATIONS IS IF ISRAELIS BECOME CONVINCED SAOAT WILL MAKE CONCESSIONS IF FURTHER DETERIORATION SETS IN AND DECIDE TO PLAY FOR TIME. THERE IS AN URGENCY IN MOVING PEACE PROCESS, BUT IN OUR VIEW IT IS A RESULT OF HIGHLY COMPLICATED POLITICAL/ECONOMIC ELEMENTS IN EGYPT
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AND WITHIN THE ARAB WORLD AND NOT FROM CURRENT ECONOMIC DIFFICULTIES.

-- IS THERE ANY EVIDENCE OF AN ANTIU.S. BACKLASH IN PRESENT DEVELOPMENTS?

ALTHOUGH ONE HEARS WIDESPREAD PRIVATE COMMENTS THAT THE U.S. (AMONG OTHERS) IS NOT DOING ENOUGH FOR EGYPT AND THAT, IN PEACE PROCESS, U.S. COULD MAKE ISRAEL DO WHATEVER IT WANTED, THERE HAVE BEEN SURPRISINGLY FEW MANIFESTATIONS OF ANTI-AMERICANISM. FOR THE TIME BEING THE STALEMATED PEACE PROCESS IS BLAMED SQUARELY ON BEGIN. PUBLIC CRITICISM ABOUT THE SLOW EGYPTIAN UTILIZATION OF AID FUNDS (FROM ALL DONORS) HAS OCCASIONALLY APPEARED AND IN TURN RAISED QUESTIONS ABOUT WHERE THE DONOR MONEY HAS GONE. EVEN EDUCATED EGYPTIANS HAVE A POOR UNDERSTANDING OF THE WORKINGS OF OUR AID PROGRAM AND THE EXTENSIVE BILATERAL NEGOTIATIONS REQUIRED. CRITICISM HAS NOT APPROACHED LEVEL THAT COULD BE CALLED BACKLASH. THIS ABSENCE OF CRITICISM OO U.S. ON ALL COUNTS COULD CHANGE RAPIDLY IF THE PEACE -PROCESS WERE TO BE INDEFINITELY STALEMATED.

--WHAT APPROACHES IS GOE MAKING TO ARAB DONORS IN SEEKING RESOLUTION TO CURRENT ECONOMIC DIFFICULTIES?

DESPITE TEMPORARY RESOLUTION OF 1976 ARREARS ON EXTERNAL OBLIGATIONS (PRIMARILY AS RESULT OF SUBSTANTIAL GODE CASH INFLOWS IN 1977), EGYPT WILL FACE RECURRING FX SHORTAGES FOR FORESEEABLE FUTURE AND CONTINUED CASH ASSISTANCE WILL BE REQUIRED TO STAVE OFF LIQUIDITY CRUNCH THAT COULD EASILY REOCCUR. WHILE GOE HAS MAINTAINED FAIRLY FREQUENT CONTACTS WITH GODE MANAGING DIRECTOR DUKHAIL AND STAFF,
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AS WELL AS THROUGH BILATERAL CHANNELS AT SUBMINISTERIAL

LEVEL, GOE HAS FAILED TO FORMALIZE THESE CONTACTS (FOR REASONS PARTIALLY OF A TACTICAL NATURE) OR INSTILL MORE CONFIDENCE AMONG ARAB DONORS IN EGYPT'S ABILITY TO UTILIZE AID AND/OR GOE'S ABILITY TO MANAGE MONEY AND CONTROL COUNTRY'S ECONOMIC SITUATION. WE BELIEVE MUCH MORE COULD AND SHOULD BE DONE TO IMPROVE EGYPT'S RELATIONS WITH CODE MEMBERS AT HIGHER POLITICAL AND ECONOMIC LEVELS TO INSURE A CONTINUED STEADY FLOW OF BALANCE OF PAYMENTS ASSISTANCE.

RETIREMENT OF ARREARS DURING 1977, HOWEVER, HAS ALSO IMPROVED EGYPT'S POSITION VIS-A-VIS COMMERCIAL BANKING SECTOR AND LAST HALF OF 1978 IMPORT BILL COULD PROBABLY BE FINANCED COMMERCIALY. THIS WOULD ONLY BE A TEMPORARY SOLUTION, HOWEVER, BECAUSE RECOURSE TO THE BANKING SECTOR NOW WOULD ONLY PROMPT A LIQUIDITY PROBLEM IN 1979. GOE ECONOMIC GROUP AND CENTRAL BANK ARE WELL AWARE OF THIS PROBLEM AND HAVE BEEN PUSHING CODE REPLENISHMENT DURING VARIOUS VISITS IN FIRST QUARTER OF YEAR, AND MOST RECENTLY, AT ARAB FUND MEETINGS IN KUWAIT AND SUBSEQUENT BILATERAL VISIT TO ABU DHABI.

EGYPTIAN IMPORTUNING HAS MET WITH LITTLE APPARENT RESPONSE ON PART OF DONORS THUS FAR. DUKHAIL HAS MADE POINT TO USG OFFICIALS THAT CODE WANTS OUT OF BALANCE OF PAYMENTS ASSISTANCE AND TO RESTRICT ITSELF LARGELY TO PROJECTS IN FUTURE. WE HAVE HEARD THIS BEFORE, HOWEVER, AND ASSUME THAT A MODUS VIVENDI WILL BE WORKED OUT WHEREBY ADDITIONAL CODE MONIES WILL BECOME AVAILABLE FOR IMPORTS UNDER ONE ARRANGEMENT OR ANOTHER. (GIVEN IBRD ESTIMATE OF \$2 BILLION IN PROJECT PIPELINE, STRONG CASE CAN BE MADE THAT COMMODITY IMPORT ASSISTANCE IS APPROPRIATE AREA FOR ANY INCREMENTAL AID THAT CAN BE PROFERRED WITH A DEGREE OF FLEXIBILITY AS TO FORM.) WE WOULD NOT EXPECT TO SEE CODE ARAB STATES ABANDON EGYPT FINANCIALLY, BUT TIME WILL
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SOON GET TO BE OF THE ESSENCE ON SUBJECT OF REPLENISHMENT OF FUNDS.

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--WHAT ROLE, IF ANY, ARE ARAB OPPONENTS PLAYING SHAPING
EITHER THE PROBLEM OR SOLUTION?

ROLE OF ARAB OPPONENTS IN SHAPING POLICY IS EXCEEDINGLY
LIMITED; SADAT LARGELY HAS WRITTEN THEM OFF, OR DIS-
MISSED THEM AS IRRELEVANT. THIS PARTICULARLY TRUE FOR
IRAQ, SOUTH YEMEN, LIBYA AND CURRENT PLO LEADERSHIP.
ALGERIA, OO, HAS LITTLE INFLUENCE IN CAIRO. SYRIA
ALONE AMONG REJECTIONISTS VIEWED AS POTENTIALLY
IMPORTANT ELEMENT IN ACHIEVING COMPREHENSIVE SETTLEMENT.
HOWEVER, SADAT CLAIMS (WE THINK HONESTLY) THAT SYRIAN
OBJECTIONS TO INITIATIVE LARGELY DESIGNED FOR INTERNAL
CONSUMPTION AND THAT ASSAD, IN END, WILL COME AROUND AS
HE HAS BEFORE, MOST NOTABLY FOLLOWING SINAI I. ON PLO,
SADAT CASTING ABOUT TO DEVELOP ALTERNATIVE LEADERSHIP,
THUS FAR WITH LITTLE SUCCESS. PENDING BREAKTHROUGH IN
NEGOTIATIONS WITH ISRAEL, HE UNDOUBTEDLY VIEWS THIS AS
SOMETHING WHICH CAN BE POSTPONED AND IS PROBABLY PLEASED
TO HAVE FREE HAND IN NEGOTIATING PROCESS. SO LONG AS
ULTIMATE SOLUTION FALLS WITHIN PARAMETERS OF SADAT'S
STATED "PRINCIPLES", HIS ARAB OPPONENTS HAVE LITTLE
INFLUENCE SHAPE EGYPTIAN POLICY.

--ARE OTHER ARAB GOVERNMENTS LIKELY TO SEEK SIGNIFICANT
POLITICAL CONCESSIONS FROM SADAT (E.G. RECONCILIATION
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WITH "REJECTIONISTS") AS PRICE FOR SUPPORT IN SOLVING
PROBLEMS?

ISRAELI FEARS AND ALLEGATIONS TO THE CONTRARY, THERE IS
LITTLE EVIDENCE THAT SADAT IS SIGNIFICANTLY INFLUENCED
BY OTHER ARAB STATES, LEAST OF ALL IN HIS RELATIONS WITH
"REJECTIONISTS." EGYPTIANS BELIEVE THAT SAUDI AND GULF
STATES' FINANCIAL SUPPORT FOR EGYPT HAS BEEN NIGGARDLY,
GIVEN THEIR WEALTH. FURTHERMORE, SOME SENIOR EGYPTIANS
BELIEVE THIS AID IS GIVEN PRIMARILY AS INSURANCE AGAINST

RE-EMERGENCE OF A RADICAL REGIME IN EGYPT THAN FOR SERIOUS ECONOMIC PURPOSES. THUS USE OF ECONOMIC RATIONALE FOR KEEPING GOE ON SHORT LEASH IS NOT CONVINCING TO THEM. ONE OF PARADOXES OF SADAT'S MODERATE POLICIES IS THAT IF HE WERE TO ADOPT A MORE THREATENING STANCE TOWARD THE CONSERVATIVE REGIMES, HE WOULD PROBABLY RECEIVE CONSIDERABLY MORE AID.

NEVERTHELESS, THERE ARE SAUDI IMPOSED LIMITS BEYOND WHICH SADAT WOULD PROBABLY NOT RISK STRAYING; SPECIFICALLY, FEAR OF SAUDI REACTION TO A BILATERAL AGREEMENT AND THE NECESSITY OF ACHIEVING A SOLUTION TO JERUSALEM PROBLEM SATISFACTORY TO THEM. ON BROADER ARAB FRONT, SADAT MUST ALSO TAKE INTO ACCOUNT POSSIBILITY OF REPRISALS AGAINST EGYPTIAN WORKERS IN ARAB COUNTRIES GIVEN TIGHT EMPLOYMENT PROBLEM AT HOME AND IMPORTANCE OF THEIR REMITTANCES. --WHAT IS BACKLASH POTENTIAL OF FUNDING DEMANDS RE US MILITARY PURCHASES?

WE ARE UNCLEAR AS TO WHAT "BACKLASH" IS REFERRED TO IN THIS QUESTION--A RELUCTANCE ON PART OF NON-CONFRONTATION ARAB STATES TO SUPPORT PURCHASES OF US MILITARY EQUIPMENT BY EGYPT; AN ADVERSE REACTION FROM IMF ITSELF; AN

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INTERNAL EGYPTIAN BACKLASH AGAINST US INDIVIDUALS OR GOVERNMENT BECAUSE OF SALES; OR SOME OTHER VARIATION ON THEME. IT MAY BE NOTED THAT BULK OF EXTERNALLY-PROVIDED SUPPORT FOR EGYPTIAN MILITARY NOMINALLY HAS BEEN OUTSIDE USUAL FINANCIAL CHANNELS. MORE OFTEN THAN NOT, EQUIPMENT IS ORDERED, PAID FOR AND DELIVERED WITHOUT FUNDS EVER ENTERING EGYPTIAN SYSTEM. PAYMENTS UNDER KHARTOUM AND RABAT AGREEMENTS ARE NOT INCLUDED SPECIFICALLY AS PART OF ARAB MILITARY FUNDS, ALTHOUGH AT LEAST PORTION OF RABAT PAYMENTS WERE MADE WITH IDEA OF REEQUIPPING ARMY AFTER 1973 WAR. AS KEY MODERATE MEMBERS OF NON-CONFRONTATION GROUP, E.G., SAUDI ARABIA AND KUWAIT, HAVE CONTINUED THESE PAYMENTS DURING 1977 AND ALSO PROVIDED OTHER DIRECT MILITARY ASSISTANCE, WE PERCEIVE NO EVIDENCE OF "BACKLASH" WHICH MIGHT RESULT IN DECLINING SUPPORT FOR MILITARY ON PART OF THESE STATES AS CONSEQUENCE OF ECONOMIC PROBLEMS. AS IN PAST, MILITARY ASSISTANCE WILL BE RELATIVE TO PERCEIVED THREAT TO SADAT REGIME AND DEFENSE REQUIREMENTS. MOREOVER, THESE FUNDS WILL BE INCREMENTAL IN NATURE AND UNRELATED TO DEVELOPMENT ASSISTANCE (THUS FORESTALLING POSSIBLE IMF OBJECTION). IN PAST ARABS HAVE FUNDED PURCHASES FROM NUMBER OF EUROPEAN COUNTRIES; WE SEE NO REASON WHY THEY WOULD NOT DO SAME FOR US EQUIPMENT, PARTICULARLY AS IT IS SEEN AS SUPERIOR IN MANY INSTANCES. EILTS

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